May 12, 2005

Comment regarding FIL-41-2005

By: J. Robert Shearer
Shearer, Taylor & Co., P.A.
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Background – Our firm provides services almost exclusively to financial institutions. We have on client that is an SEC registered accelerated filer (and has assets in excess of $500 million), two non-public clients with assets in excess of $500 million, and approximately 20 other audit clients with assets less than $500 million.

I am also attaching a copy of a memo that was sent to all of our audit clients.

My comments:

I concur with Proposed Interagency Advisory.
As stated in my memo to our clients, my concurrence is based on my agreement with the SEC's conclusions that any such arrangements with a client would impair our firm's independence. The safety and soundness issues are for the banking regulators to debate, but our firm's independence is my primary concern related to this matter. I am aware that other firms use such language (often at the encouragement and / or insistence of professional liability carriers), but our engagement letters have never included such language.

I do have some concern regarding Example 4 in Appendix A.
(See the comments in my memo to our clients.) As stated in our engagement letter (see my memo) we can only be liable for audits that we actually perform. While losses that occur in subsequent periods may be related to matters that existed during periods that we audited, we cannot be liable for subsequent audits that we do not perform. This is the point of the language in our engagement letter. I realize that litigation related to our audits may not occur until subsequent periods (and we may no longer be the financial institution's auditors), but I do not see that our language limits our liability for our audits in any way. We have put no time frame on losses or litigation related to periods that we have audited, we have simply stated that the current engagement letter covers only the current period that we are auditing.

Since the purpose of our engagement letters is to clearly establish the responsibilities of our firm and our banking clients related to an annual audit (and other services), in my opinion, the sentence that we include is necessary language in any annual engagement letter. We have clearly established the fact that we are responsible to audit what we have been engaged to audit and that we are not responsible to audit what we have not been engaged to audit. Our language says nothing about losses occurring in later periods as is shown in Example 4 of Appendix A.

However, I can foresee examiners challenging this language, when I do not believe that it is contrary to the issue that is actually raised in Example 4 of Appendix A. I would recommend that the language used in our engagement letter (or similar language) be given as an example, in the final advisory, as acceptable language that could be included in annual audit engagement letters.

May 12, 2005

File Memo

Subject: FIL-41-2005

By: Bob Shearer
Shearer, Taylor & Co., P.A.

Copy to: Gerald
Lance
Audit Clients

On May 10, 2005, the FDIC published FIL-41-2005, "External Audit Engagement Letters Unsafe and Unsound Use of Limitation of Liability Provisions and Certain Alternative Dispute Resolution Provisions." The summary paragraph of the FIL states that "The proposal advises financial institutions' board of directors, audit committees, and management that they should ensure that they do not enter into any agreement that contains external auditor limitation of liability provisions with respect to financial statement audits."

Our engagement letters do not contain any such language or provisions.

I am aware that some firms do include such language in their engagement letters. The FDIC premise that this represents and unsafe and unsound banking practice for the financial institution is not really an issue for me. However, I concur with SEC conclusion that such arrangements would impair the auditor's independence with respect to the client.

As a point of clarification, Item 4 of Appendix A (Examples of Limited Liability Provisions) discusses "Losses Occurring During Periods Audited Provisions." The example given (for inappropriate language) is as follows, "In the event the financial institution is dissatisfied with (the audit firm's) services, it is understood that (the audit firm's) liability, if any, arising from this engagement will be limited to any losses occurring during the periods covered by (the audit firm's) audit, and shall not include any losses occurring in later periods for which (the audit firm) is not engaged as auditors." Please note that your engagement letter has the following language as the last sentence in paragraph four, "Our responsibility as auditors is limited to the period covered by our audit and does not extend to any later periods for which we are not engaged as auditors."

In my opinion, there is a significant difference in the two statements. Our language makes no reference to limitation of liability and is in no way premised on satisfaction or dissatisfaction with our services. Our engagement letter simply states that we are your auditors for the period covered by the engagement letter (the current year audit) but we are not your auditors for subsequent periods (until you sign an engagement letter engaging our firm as you auditors for the next year). Although we have a long-term relationship with our financial institutions, we are engaged one year at a time rather than on a perpetual basis.

Based on my analysis, I do not believe that there will need to be any revision to our engagement letters related to FIL-41-2005. Please note that I plan to comment on FIL-41-2005 to concur with the FIL and to obtain clarification regarding the language in our letter regarding "our responsibility as auditors."